

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

DISCOVER FINANCIAL SERVICES NSA

MC2015-3

DISCOVER FINANCIAL SERVICES NSA

R2015-2

**Reply Comments of Discover Financial Services
(November 21, 2014)**

I Comments of the Public Representative & Valpak

While suggesting different Commission actions, the primary thrust of the Comments of both Valpak and the Public Representative is that the NSA between the Postal Service and Discover does not pass the Panzar test, which the Commission designed to ensure that declining block rate NSAs provide a net financial benefit to the Service. The failure to pass the test is both unsurprising and completely irrelevant.

It is unsurprising because the test was developed for an agreement with declining block rates and without penalties. In contrast, this NSA does not have declining block rates and does have penalties. Thus, the agreement does not pass a test that was not developed for agreements of its type.

But it is also irrelevant. As shown in DFS-LR-1, under the type of methodology that the Commission has used in the past, this agreement, evaluated at Postal Service “before rates” volumes, provides a net financial benefit to the Service as shown by a test properly modified to reflect the actual circumstances¹ of the agreement. And importantly, the deal provides a net financial benefit across a wide range of “before rates” volumes estimates,

¹ Administrative agencies are to resolve cases based upon the facts of the specific case before them. This is not a rulemaking. See *Londoner v. City and County of Denver*, 210 U.S. 373 (1908); *Bi-Metallic Investment Co. v. State Board of Equalization*, 239 U.S. 441 (1915).

including volumes that are much higher than the Postal Service's "before rates" estimate and FY 2014 Discover volume.

Finally, Discover submits that it is generally not possible for a mailer, let alone the Postal Service, to precisely create before rate volume projections, particularly for marketing material, let alone quantitatively "prove" its accuracy to the Commission. It certainly is not possible in Discover's case, as the Talwar Statement demonstrates. Thus, this type of sensitivity analysis with respect to "before rate" volume projections can be one way to inform the Commission in its evaluation of the likely effect of a deal on Postal Service finances.

II Under the Facts of this Case, this NSA will Improve the Financial Position of the Postal Service

In individualized decision-making, as with quality clothing, one size does not fit all. See generally Richard J. Pierce, Jr., *Administrative Law Treatise* (5th ed. 2010) at 705. With this principle in mind and with the recognition that no quantitative analysis can fully capture the effect of this NSA on Discover's decision making, Discover provided the Commission with the Statement of its CMO Harit Talwar.² We did so in order to give the Commission a more individualized understanding of: how Discover markets, the relationship of mail and the targeted digital channels in Discover's marketing, and how Discover's granular marketing decisions preclude reliable quantitative projections. The marketing decisions of Discover's teams are integrated decisions using more than two score of interrelated and interdependent criteria, only one of which is price.

The critical facts in this case are that a majority of Discover's new accounts are now acquired through digital channels, not mail. That means that digital marketing, not mail, is Discover's prime means of acquisition. The

² Discover very deliberately chose its Chief Marketing Officer to make this statement, in order to underscore the seriousness with which the company views this matter, and the importance the company places on the Commission understanding its marketing approach and choices. We deliberately chose an Officer of the company to make this statement, in order to add to it the credibility that would accrue from a Officer's word, and Mr Talwar was the appropriate person since this is his area, and he knows more about it than anyone else.

consequence for Discover is that, in the normal order of business, Discover would move marketing funds from mail to digital, as the Talwar Statement states.³ Statement of Harit Talwar at 4-5. This NSA changes the normal order of business, and precludes that shift, and the loss of contribution for the Postal Service that would go with that shift.

We respectfully submit that these facts provide sufficient grounds upon which to approve this NSA under both the spirit and the letter of the PAEA. This NSA is a business deal, just like those made every day by business throughout the country. It is exactly the type of deal that Congress intended in the PAEA that the Postal Service should make, in order to better position itself to compete more effectively with digital alternatives.

III Observations of The Public Representative on the NSA

The Public Representative's Comments come close to agreeing that from a business perspective, this NSA is a good deal for the Postal Service:

The Postal Service may have designed this NSA to balance risks and benefits. . . . it is understandable that the Postal Service would be willing to trade \$8 million in contribution for the certainty that one of its largest customers will continue to mail at a high level. It is logical for companies to trade risk for certainty."

Pub Rep Comments at 21.

The PR also suggests that 1) trading risk for certainty only makes sense where the Postal Service has a reasonable basis to believe that revenue from Discover will decline, and 2) the record in this case does not support this conclusion. This is where we respectfully disagree.

First, as DFS-LR-1 shows, the Postal Service would benefit from this deal even if "before rates" volumes were somewhat higher than in FY 2014. Second, the record in this case is full, and supports the conclusion that the Postal Service has a reasonable basis to believe that its Discover revenue will decline but for

³ The key to resolving this case is fully realizing the fact that, for Discover, the Postal Service simply is no longer a monopoly in terms of Standard Mail; and that it has no market dominant power over Discover. As a customer, this fact is clear us. It is clear to the marketing people at the Postal Service, and the Talwar Statement should make it clear to the Commission.

this NSA. Indeed, the facts before the Commission have been presented to by the Chief Marketing Officer of Discover himself, and his Statement should be given the considerable weight that it deserves. Discover could go no higher. And, without going into a full adjudication, Discover can do no more.

A full adjudication is not a reasonable option, a fact Congress acknowledged when it enacted the PAEA and specifically eliminated using a full adjudicative process to evaluate NSAs, along with any need for testimony, statements, cross-examination, etc. Congress consciously replaced the old system with an *extremely* abbreviated process that contemplated that NSAs should be *implemented and operating* 45 days after they were signed. 39 USC §3622 (d)(1)(C). Congress did so in order to allow the Postal Service to get to market with its market dominant NSAs within a month and a half of signing, so that it could be better placed to more effectively compete against digital products. Getting to market in a timely fashion is critical for any business to succeed.

IV The Commission Should Use a Two Step Process In this Case

Should the Commission rely exclusively on a quantitative model in arriving at a decision, it will be ignoring the *full* effect of the NSA on Discover's granular marketing decisions and its decision-making on whether to retain millions of dollars in mail or move it to digital channels. We suggest the following:

First, use the alternate test that we provided in our Comments and Library Reference to perform a traditional quantitative analysis. This type of sensitivity analysis is an appropriate first step in evaluating a likely effect of the deal on Postal Service finances under the Commission's traditional approach. The results that this test would produce, would help inform the Commission's decision. As we have shown with the modified test, this NSA provides a net financial benefit to the Service across a wide range of "before rates" volumes estimates, including volumes that are much higher than the Postal Service's "before rates" estimate and FY 2014 Discover volume.

Second, should the Commission have even the smallest doubt that the results of that test are not sufficiently conclusive,⁴ then it should take into account the full impact on the Postal Service's finances of the risk of a future Discover decision shift millions, perhaps hundreds of millions over time, of marketing dollars from mail to digital.

In evaluating this proposition, the Commission needs to do what Courts have been doing for centuries, consider what is has before it. We submit that the Commission should give the Statement of Harit Talwar, Discover's Chief Marketing Officer the considerable weight it is due. The Postal Service cannot effectively compete against digital media if the Commission does not allow it to have a significant degree of latitude in determining what to do. That means judging the credibility of how, in what fashion, and to what degree digital media pose a challenge in a specific factual context, and then what solution would work best. After all, the Postal Service is the entity out in the marketplace which gives it the best knowledge base upon which to act.

V Other Matters

The Public Rep has suggested that 1) the Commission could hold this NSA in abeyance, or 2) conditionally approve it for a shorter period, while opening a rulemaking. Pub Rep Comments at 23. Setting aside the rulemaking issue, these are not good suggestions. Moreover, they fly in the face of Congress' desire to see the Postal Service act more quickly, more simply, like a business, in order to compete more effectively in the digital era.

Additionally, there is nothing in the law that gives the Commission the power to do either, and for good reason. Contracts are written legal instruments that embody the final "meeting of the minds" of the parties that formed the bargain. That bargain is the product of long negotiations in which one party trades one point for another. As such, contracts embody a delicate balance of

⁴ This is the exactly the way Discover and other business and makes decisions. Discover has many models—and they are cutting edge models— and Discover uses them to inform its decisions, but Discover does not rely on them exclusively.

interests—risks, benefits, liabilities, duties, responsibilities, and timing. Upsetting the balance rebalances those interests, and effectively rewrites the contract. Under no circumstances should the Commission override the negotiation process, rebalance interests, and rewrite the bargain.

In terms of rulemakings, the general idea of using a rulemaking to develop a new approach is not unreasonable, but there are better ways to handle these matters. So far, there is but one new type of NSA. One has to assume that there will be many more. One cannot have a new rulemaking every time a new set of facts comes before the Commission. That is what the individualized decision-making process contained in the statute is for.

In situations such as these, it is common for administrative agencies to make individualized decisions, based on their statute and the facts of the particular case before it, and then in case after case cautiously develops patterns of precedent. In this process, principles and rules develop out of precedent, just as they did in the development of the Common Law. This is a particularly effective legal way to handle matters when the facts and context of each case vary widely. Better decisions are reached this way, and are reached in the context of real facts, as opposed to theoretical hypotheses. For decades, the FCC's Comparative Renewal Process worked in this fashion.

The Commission has before it the Discover NSA. It should approve the NSA as expeditiously as possible, on the facts before it.

Respectfully submitted,

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